

Lagarde pushes back on aggressive rate cut expectations

Today's meeting marks the end of the current rate hike cycle, but also shows that there's still a long way to go before the ECB starts cutting rates



Today's ECB meeting confirmed our base case scenario of a gradual shift towards full dovishness, with rate cuts starting in June

Today's decisions

The European Central Bank has kept policy rates unchanged, but slightly changed its communication. The policy statement signals that the end of rate hikes is here.

The removal of the phrase "*inflation is expected to remain too high for too long*" is a clear dovish signal. At the same time, however, the statement that "*rates will be set at sufficiently restrictive levels for as long as necessary*" is still in the official communication, and this suggests that the dovish shift is still a very small one. The ECB also announced a very gradual phasing out of the reinvestments under the Pandemic Emergency Purchase Programme (PEPP) in the second half of 2024. It is the timing and not the PEPP decision itself which came as a slight surprise.

ECB's take on growth and inflation

Despite their dismal track record, the ECB's staff projections will play an increasingly important role again over the coming months when deciding on whether or not to start cutting interest rates. Today's forecasts show headline inflation at 5.4% in 2023, 2.7% in 2024, 2.1% in 2025 and 1.9% in

2026. We saw a downward revision for 2023 and 2024.

Underlying inflation forecasts, however, were slightly revised upwards to 5% in 2023, 2.7% in 2024, 2.3% in 2025 and 2.1% in 2026. GDP growth is expected to come in at 0.6% in 2023, 0.8% for 2024, and 1.5% in both 2025 and 2026. These forecasts justify an end to the current rate hike cycle – but definitely do not justify aggressive rate cuts next year.

According to the ECB, the risks to growth are still tilted to the downside, while there is still no risk balance for inflation.

Lagarde's comments during the press conference

During the press conference, ECB President Christine Lagarde – still visibly recovering from Covid-triggered bronchitis – pushed back against recent market pricing of aggressive rate cuts in 2024. “We should absolutely not lower our guard”, she stated, later adding “we definitely did not discuss rate cuts today.”

Why? In the ECB's own models, the recent market pricing (with dropping interest rates across the board) came after the cut-off date of the recent forecasts and would currently yield higher inflation forecasts. So, if anything, the irony is that the recent easing of financial conditions would actually force the ECB to delay any rate cuts for longer.

Lagarde also emphasised the importance of domestic inflation, which according to her had not yet come down and was strongly affected by wage developments next year. However, when asked whether she would confirm her earlier statement that there wouldn't be any rate cuts over the next quarters, the question remained unanswered. Whether or not this was deliberate remains unclear. When asked about current market pricing of six rate cuts next year, Lagarde dodged the question.

Dovish shift but no rate cut on the radar screen (for now)

Today's ECB meeting marks the end of the current rate hike cycle and was the first tentative step towards more dovishness to come. After today's meeting, however, it should also be clear that the end of a hiking cycle does not imminently lead to a cutting cycle. This is why we still think that the ECB's road to rate cuts will be longer than markets had been pricing in during the last two weeks. In fact, it is difficult to see how the central bank could decide on a full U-turn on policy rates only on the back of a few weaker-than-expected inflation prints without headline inflation falling below 2% and longer-term inflation forecasts still being at around 2%.

The ECB's forecasting mistakes of the past are probably an almost automatically built-in brake on premature and large-sized rate cuts. We think that it would require a sharper economic downturn and/or inflation sustainably falling below 2% to see the central bank cutting rates by as much as the currently priced in 150bp. We think that it will first want to see the next round of the Bank Lending Survey and wage settlements in the first quarter of 2024 before even discussing rate cuts. Today's ECB meeting confirmed our base case scenario of a gradual shift towards full dovishness with rate cuts starting in June.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.